For these reasons, the Commission can and should reject the constitutional challenges to its authority to set interconnection and network element prices on the basis of incremental cost.

III. The Commission's Rules Should Expressly Prohibit All But A Few Narrow Restrictions On The Resale Of LECs' Retail Telecommunications Services.[39]

A. Introduction.

Section 251(b)(1) states that a LEC has an affirmative duty "not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of its telecommunications services." Section 251(c)(4)(B) creates a similar duty for incumbent LECs "not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service." Section 251(c)(4)(B) also contains an exception: "a State commission may, consistent with regulations prescribed by the Commission under this section, prohibit a reseller that obtains at wholesale rates a telecommunications service that is available at retail only to a category of subscribers from offering such service to a different category of subscribers."

Resale restrictions are inherently and unavoidably anticompetitive. Their entire purpose is to ensure that a service that is offered to one group of customers is not available to other customers. Monopolists try to segment their markets in this way so that customers who might have some alternative source of supply can be offered better terms, while customers who are fully dependent on the monopolist have no choice but to pay higher rates while watching in frustration as the preferred customers enjoy their special deals.

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[39] This section of these Reply Comments addresses Parts II.B.3. and II.C.1 of the ***Notice.***

Unrestricted resale undercuts the monopolists at every turn. If a service is made available on special terms to Customer A, a reseller can buy it on those same terms and make it available to everyone else. If the special deal for Customer A entails prices below cost (***e.g.,*** predatory prices), then the availability of unrestricted resale will force the monopolist to think twice before offering it in the first place. If the special deal covers cost, but cuts into profit margins, then the monopolist will face a difficult but competitively healthy choice: offer a better price, not just to Customer A ***but to the whole market,*** or keep prices high and risk losing customers to alternative sources of supply. Resale, therefore, imposes on the monopolist the familiar rule of economics that competitive markets lower prices to ***marginal*** cost, not just for the marginal customer, but for ***all*** customers. This improves consumer welfare by placing the "consumer surplus" with consumers, as opposed to letting the monopolist keep it.[40]

A number of LECs have proposed a variety of resale restrictions that they seem to think are neither "unreasonable" nor "discriminatory." These include bans on the resale of promotional offerings, "grandfathered" services, and single-customer arrangements.[41] In addition, while the "category of customer" restriction that state commissions ***may*** implement only applies with respect to services for which a wholesale discount is sought, some LECs appear to be requesting that these category-of-customer restrictions be applied whether or not the reseller seeks a "wholesale rate" under Section 251(c)(4).[42] Still other LECs claim that services such as directory assistance and operator services, while required to be offered under Section 251(b)(3)

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[40] ***See, e.g.,*** E. Browning & J. Browning, ***Microeconomic Theory and Applications*** (3d ed. 1989) at 342-43, 133-40; M. Bronfenbrenner, W. Sichel & W. Gardner, ***Economics*** (1984) at 416-17, 477-79, 500-02, 528-30, 533-37.

[41] ***See, e.g.,*** Comments of BellSouth ("BellSouth Comments") at 66; NYNEX Comments at 75-80; USTA Comments at 72.

[42] ***See, e.g.,*** GTE Comments at 45; BellSouth Comments at 65-66; NYNEX Comments at 79-80; USTA Comments at 71; Bell Atlantic Comments at 45.

(and, for BOCs, Section 271(c)), are not "telecommunications services" under the Act and, therefore, are not subject to a resale obligation at all.[43]

The Commission should reject each of these claims. Except for services that are explicitly subsidized and targeted to non-business consumers of limited means — resale of which can reasonably be restricted to consumers who would qualify to buy the service directly from the LEC — the Commission should establish a nationally binding rule that ***no*** restrictions on resale will be tolerated.

B. Resale Of Allegedly "Below-Cost" Services.

Some incumbent LECs claim that they should not be required to offer for resale services that they sell below cost. The basis for this claim is generally (a) that they should not be forced to "lose money" by deploying additional units of the money-losing service and (b) the service was priced below cost at the behest of a state commission to meet universal service goals.[44] Neither of these claims warrants the imposition of a blanket resale restriction.

Unsupported claims that a service (***e.g.,*** residential service) is actually priced "below cost" should be carefully scrutinized. The fact that the rate for the service set by a state commission some years ago did not, on average, cover the fully allocated embedded cost of that service as presented by the LEC in a rate case hardly proves that the rate for the service is "below cost" in any meaningful economic sense today. If a service covers its relevant economic cost today, ***i.e.,*** forward-looking incremental cost, the LEC does not "lose money" by providing additional units of the service. As a result, unless a LEC seeking to impose a resale restriction can show on the basis of current data that its price for a service is below forward-looking incremental cost, no resale restrictions should be tolerated.

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[43] ***See, e.g.,*** GTE Comments at 45 n.69; USTA Comments at 71-72.

[44] ***See, e.g.,*** GTE Comments at 45; Bell Atlantic Comments at 45.

But even if a service is, on average, "below cost" under this standard, that does not mean that resale restrictions should be allowed. This is because the claim that resale actually results in "additional units" of service being provided is also suspect. With regard to loop plant, for example, most populated areas of the country have long since been built out to provide telephone service. In these areas, it is relatively rare for a telephone company to have to actually string new wires (other than, perhaps, a drop) in order to provide "additional units" of local exchange service. The plant needed to provide "additional units" of service is already in place, waiting to be activated. The only question is the price the telephone company will be able to receive in the market for the use of its already-deployed plant.

A parallel analysis applies to usage and software-based services (***i.e.,*** many vertical features) as well. These types of services are typically "costed out" on the basis of capacity required at the busy hour. Unless there is some reason to think that the resold usage/software-based services will impose additional busy hour requirements, the cost of "additional units" is essentially zero. Particularly at the early stages of local exchange competition, resale will be used by new entrants to take business away from the incumbents, so the presumptive effect on busy hour requirements is also zero. Over time, as new entrants deploy their own facilities in addition to using the incumbent LEC's facilities for resale, some of the busy hour requirements on the incumbents will actually be reduced.[45]

In the end, the real question is why a particular service is priced below cost, if indeed, it is. If the below-cost pricing is not related to universal service objectives, it is simply anti-competitive. The solution for the LEC is to raise the price sufficiently to cover cost. Any economic pain occasioned by having to resell the below-cost service in the interim is, from this perspective, simply a healthy economic incentive to cease engaging in predatory practices. But even if the below-cost pricing ***is*** related to universal service objectives, the solution is not to bar

[45] In this regard, a new entrant's switches, transmission facilities, etc., reduce the load on the incumbent's facilities just as surely as if the incumbent had itself placed those new switches and transmission facilities.

resale of the service entirely. At most, this would justify restricting resale of the service to the same class of customer entitled to the universal service discount. If the LEC would be prepared to deploy new units of the service for the use of the preferred class of customers (presumably residence customers), there is no reason to permit the LEC to prohibit resale to those same customers.

This discussion has profound implications for the ability of firms to compete with incumbent LECs by means of shared tenant services ("STS") operations. One of the potential ways that STS operators can make competitive inroads on the incumbent LECs is by aggregating many customers' usage on a smaller number of lines or trunks, ***i.e.,*** obtaining a wholesale versus retail margin by taking advantage of trunking efficiencies. For example, a 100-unit apartment building served by the incumbent LEC will have 100 (or more) individual residence loops connecting it to the central office, but an efficient STS provider might be able to provide equal quality service with only (say) 40 loops, since only in the rarest cases would more than 40 residents be on the telephone ***at the same time.***

The viability of STS operations, however, is often constrained by resale restrictions imposed by the incumbent LECs. For example, it is not uncommon in some areas for STS providers to be limited to reselling either business service only (even if the end-users are residential customers), or even measured-rate business service only (even if the LEC itself offers a flat-rate business service option).[46] In addition, some LECs have refused to sell PBX trunks

[46] ***See, e.g.,*** NYNEX Comments at 80. The claimed justification for this restriction — that rates were set with particular usage levels in mind, and resellers will exceed those levels — reads the enactment of Sections 251(b)(1) and 251(c)(4) out of existence. If this justification is accepted, then any service whose rate was not set with resale in mind does not have to be resold, elevating a LEC's pre-1996 Act tariffs to a status superior to the Act itself. Also, note that a claim that particular rates as initially set did not include an allowance for as much usage as a reseller might create is a far cry from a claim that the rates do not cover cost at the higher usage levels. As discussed above, if a rate covers cost (properly defined), then there is no conceivable basis for banning resale. Therefore, unless an incumbent LEC can show, using current data, that a flat-rated service will fall below (continued...)

to STS providers if the STS provider's switch is not physically on the same premises as its customers. The sole purpose of these restrictions is to make it hard for STS providers to compete with the LECs for end users, and the Commission should make clear that such restrictions are no longer permissible under the terms of Sections 251(b)(1) and 251(c)(4).

C. Other Resale Restrictions.

1. Customer-Specific Offerings.

Some LECs argue that customer-specific offerings should not be subject to resale.[47] The only conceivable motivation for restricting resale of single-customer offerings is anticompetitive, and such restrictions should be rejected. Suppose an incumbent LEC has offered a special deal to a large business customer. If the LEC is willing to offer that same deal to anyone similarly situated, a reseller who is willing to meet the criteria of "similarity" — volume or term commitments, facilities in a concentrated location, etc. — should be able to obtain the same deal and undertake the risk of obtaining enough customers to pay the price of the service. If the deal really is restricted to a single customer, then at a minimum, the reseller should be permitted (with the customer's authorization, of course) to have all bills sent to the reseller instead of the customer and to act as the customer's agent in connection with the resold service (and any other services the customer might want to buy).

The LECs' reason for resisting such a requirement can only be a desire to maintain "customer control," ***i.e.***, to exclude others from dealing with that customer. In competitive markets, however, the only way to maintain "customer control" is by offering better service than

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[46](...continued)
forward-looking incremental cost at levels of usage reasonably anticipated from resellers, restrictions of this sort should not even be considered, much less sustained.

[47] ***See, e.g.,*** USTA Comments at 72-73

one's competitors. If the LEC can meet that market test, then a reseller will not be able to convince the customer to turn the account over to the reseller. But if the LEC cannot meet this test, there is no possible reason for using state or federal regulations to keep the resellers at bay.[48]

2. Promotional Discounts.

The analysis of promotional discounts is similar.[49] If a LEC is prepared to offer end users a reduced rate for (say) six months in order to induce customers to sign up for a service, then it should be required to allow resellers to obtain the service at the same reduced rate to try to sign up new customers for their resale operations. The only conceivable rationale for a LEC's refusal to do so is a natural, but anticompetitive, desire to keep all the new customers of a service for itself. Again, there is no possible reason for using governmental regulatory authority to help the LECs gratify this desire.

It is not unreasonable, however, to exclude promotional rates from the obligation to offer services for resale at a discount.[50] The reason is that the difference between the normal price for a service and its promotional rate, multiplied by the number of customers who take advantage of the promotion, is itself a "marketing cost" that should be treated as "avoided" in calculating the wholesale discount in the first place. As long as the wholesale discount is calculated with these forgone revenues treated as avoided marketing costs, applying the wholesale discount to the promotional price itself would be double counting.

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[48] In this respect, "grandfathered" services are just like single-customer services. ***See*** NYNEX Comments at 75. If a LEC has legitimately obtained regulatory approval to cease offering a particular service to new customers, then it is not unreasonable for resellers to be banned from selling additional units of such services to new customers. But nothing would support prohibiting a reseller from (with the customer's consent) "acquiring the account" of a customer who subscribes to a "grandfathered" service and managing the customer's future use of that service, along with the customer's other telecommunications needs.

[49] ***See, e.g.,*** NYNEX Comments at 76-77; Bell Atlantic Comments at 45-46.

[50] NYNEX Comments at 76.

3. Operator Services and Directory Assistance.

Finally, the Commission should reject LEC arguments that services such as operator services and directory assistance are not "telecommunications services" under the law and, therefore, not subject to a resale obligation. Operator services in the sense of "call completion" all involve ways that customers can complete calls other than simply direct-dialing them. This falls squarely within the definition of a "telecommunications service" under Section 3(46) of the Act. Directory assistance services are also "telecommunications services" in that they involve the establishment of a connection between points of the customer's choosing — the customer and the directory assistance operator. Moreover, the predominant, if not the only, reason that customers call directory assistance is to permit them to complete calls to third parties. This is indicated, for example, by the growing popularity of services that allow a customer to automatically connect to the number requested from directory assistance. Directory assistance is, therefore, reasonably classified as a "telecommunications service" in its own right. In order to avoid confusion on this issue, the Commission should expressly state that these services are indeed "telecommunications services" under the terms of the Act.[51]

IV. The Commission Should Require Incumbent LECs To Provide New Entrants With "Cellular Type 1" Interconnection, At Rates Consistent With Sections 251 And 252.[52]

Section 251(c)(2) requires incumbent LECs to offer interconnection "at any technically feasible point" in their network. Some attention was paid in the comments to interconnection architectures such as that mandated by the Maryland Public Service Commission,

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[51] Alternatively, these activities (and/or the facilities and functionalities used to provide them) should be classified as "network elements") under the definition of Section 3(29) of the Act. Under this classification, while they would not necessarily be available for resale by all comers, they would certainly be available to new entrant LECs under Section 251(c)(3) at cost-based, non-discriminatory rates.

[52] This section of these Reply Comments addresses Part II.B.2.a. of the ***Notice.***

under which a new entrant must either interconnect at an incumbent LEC's access tandem, in which case traffic may be terminated to any end office subtending the tandem, or to a single end office, in which case calls may be terminated to that end office only.[53]

There is nothing necessarily wrong with such an interconnection architecture in many cases. Indeed, there is a natural tendency to look to access tandems as the point of interconnection for obtaining access to a large number of end offices, since that is the function of access tandems in the first place. There is, however, another way to obtain connections to a large number of end offices that may be of more benefit to new entrants who are not entering the market from the position of an embedded access user (AT&T, MCI) or access provider (MFS, Teleport Communications Group). This is a so-called "Cellular Type 1" interconnection.

Under this type of connection, the cellular carrier's switch is connected to the end office in essentially the same manner as a PBX connects to the end office. Just as a typical PBX user can make calls over PBX trunks to reach any point on the public switched network, so too can a cellular customer use a Type 1 interconnection to call anywhere. Similarly, calls bound for the cellular carrier over a Type 1 interconnection are properly routed by the landline network to the outbound "PBX" trunks connecting the end office to the cellular switch.

This Commission has recently described Type 1 interconnection as follows:

> Type 1 service involves interconnection to a telephone company end office similar to that provided by a local exchange carrier to a private branch exchange (PBX). Type 1 interconnection involves an end office connection that combines features of line-side and trunk-side connections and uses trunk-side signalling protocols. Type 1 interconnections enable the CMRS provider to access any working telephone number, including all NXX codes within the LATA of the LEC

[53] ***See*** Comments of the Maryland PSC, Appendix A, In re Application of MFS Intelenet of Maryland, Inc., Phase II, Order No. 71155 at 37-41 (Jan. 25, 1994) (establishing the requirement of tandem interconnection in order to obtain LATA-wide access to end offices).

providing the interconnection. The Type 1 connection also permits access to Directory Assistance, N11 codes, and service access codes.

In the Matter of Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Services, ***Notice of Proposed Rulemaking and Notice of Inquiry***, CC Docket No. 94-54, FCC 94-145, 9 FCC Rcd 5408 (1994). Clearly, this type of connection works as a technical matter. It is also likely to be very useful for potential new entrants into the local exchange business who are trying to expand "upward" into the local exchange market from STS operations, as compared to new entrants trying to expand "downward" from long distance or "horizontally" from competitive access. This is the situation facing Jones in Alexandria, Virginia, where it began operations as an STS provider under Virginia law in advance of either the passage of the 1996 Act or the final promulgation of rules for local exchange competition under Virginia law.

The only question, then, is how the pricing for a PBX-like interconnection for a new entrant would be determined. Jones submits that there is no reason to apply any special or different pricing standards to a competing LEC seeking to interconnect by means of a Cellular Type 1 interconnection than to any other type of interconnection for the mutual exchange of traffic: reciprocal compensation for traffic exchanged, based on incremental transport/termination costs (Section 252(d)(2)), with relevant network elements and/or specific interconnections at "cost-based" rates (Section 252(d)(1)).

For several reasons, the Commission should specifically reject any claim that this type of interconnection arrangement between two LECs should be subject to analogous tariffed rates, as opposed to the pricing standards contained in the statute. First, such a claim would elevate incumbent LEC tariffs over the specific terms of federal law. There is obviously no legal or policy basis for doing so. Second, unlike some access services, which LECs claim ***are*** "cost based" in some meaningful sense, LECs often claim that business rates (PBX trunks, usage, etc.) are priced above cost in order to provide a subsidy for residential customers. It follows that applying the analogous tariffed rates to a Type 1 interconnection would on its face violate the

cost-based pricing standards in the law. Third, applying end user tariffs to LEC-to-LEC interconnections is inconsistent with the co-carrier relationship contemplated by the Act.[54] Finally, there is no realistic basis for the concern that PBX users in general would be able to arbitrage the lower interconnection costs (as compared to tariffed PBX rates) that would result from applying the pricing rules in the statute. Those lower rates are available only in connection with the provision by the interconnector of telecommunications services, ***i.e.***, services provided to third parties. Business users who happen to own PBXs do not meet this requirement and would not be entitled to the lower cost form of interconnection.

For all of these reasons, the Commission's rules should specifically indicate that a Cellular Type 1, PBX-like interconnection architecture is "technically feasible" under the Act, and that incumbent LECs must provide such interconnections to new entrants at prices that conform with the pricing standards for interconnection and traffic exchange under Section 252(d).

[54] ***See*** In the Matter of The Need to Promote Competition and Efficient Use of Spectrum for Radio Common Carrier Services, ***Memorandum Opinion and Order,*** FCC 86-85, 59 Rad. Reg. 2d (P&F) 1275 (1986) at Appendix B, ¶ 3.

Conclusion

Jones commends the Commission for its diligent efforts to transform the nation's local exchange markets from monopolistic to competitive status, and requests that the Commission adopt rules consistent with Jones's Comments and Reply Comments herein.

Respectfully submitted,

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